Are Walsh and Seward's (1990) Dimensions for Classifying Antitakeover Defenses Critical from a Stockholder Wealth Perspective? An Empirical Examination

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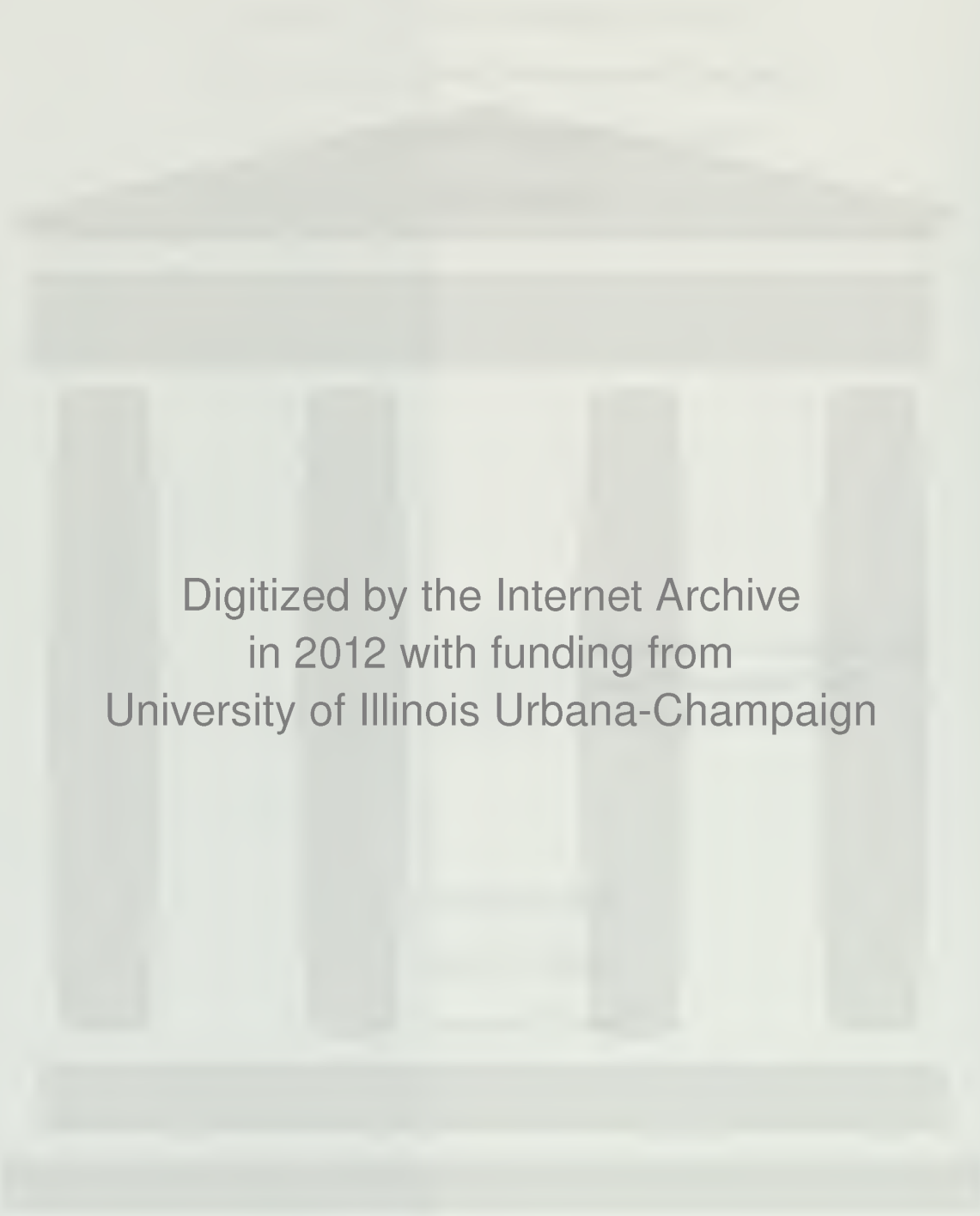
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ARE WALSH AND SEWARD'S (1990) DIMENSIONS FOR CLASSIFYING ANTITAKEOVER DEFENSES CRITICAL FROM A STOCKHOLDER WEALTH PERSPECTIVE? AN EMPIRICAL EXAMINATION[1]

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ABSTRACT

This paper examines the relationship between the passage of six types of corporate charter antitakeover amendments (supermajority, classified boards, fair price, reduction in cumulative voting, anti-greenmail and poison pills) and stockholder wealth. Our event study from a sample of 379 firms that adopted 483 antitakeover amendments in the 1984-1988 period indicates a strongly negative effect on stockholder wealth in support of the managerial entrenchment hypothesis that antitakeover amendments are adopted by managers at the expense of stockholders. In addition, we find that the market reacts equally negatively to both non-operating amendments that require stockholder approval and to operating amendments that do not require stockholder approval.

Corporate governance researchers are primarily interested in governance mechanisms that reduce the agency costs of separation of ownership from control (Zahra & Pearce, 1989). They are increasingly focusing attention on understanding the effectiveness of these mechanisms within specific governance contexts (Baysinger, Kosnik & Turk, 1991; Kosnik, 1990; Singh & Harianto, 1989) including the adoption of antitakeover amendments (Davis, 1991; Mallette & Fowler, 1992; Rechner, Sundaramurthy & Dalton, In Press). Antitakeover amendments are changes to a company's corporate charter intended to discourage a hostile bidder from taking control of the company. The adoption of antitakeover amendments is seen as a governance context in the management literature because amendment adoption is assumed to be detrimental to stockholders' interests (Kesner & Dalton, 1985).

In addition, there is some agreement in the governance literature that all amendments are equally detrimental to stockholders (Kesner & Dalton, 1985; Mallette, 1991; Rechner, Sundaramurthy & Dalton, In Press). Although the relationship between amendment adoption and stockholder wealth has received modest empirical attention from financial economists, we have limited empirical evidence about amendments' differential impact on stockholder welfare. Does each amendment have a negative impact on stockholder wealth? More importantly, do some types of amendments have more negative impact than others?

The current study examines stockholder wealth effects of the adoption of six antitakeover amendments. The main purpose of the study is to understand if different groups of amendments have a differential effect on stockholder wealth. We used Walsh and Seward's (1990) theoretical framework for distinguishing between amendment groups and test their differential stockholder wealth effects.

DESCRIPTION OF ANTITAKEOVER AMENDMENTS

Supermajority merger approval provisions typically stipulate stockholder approval percentages in the 66-80 percent range. Various supermajority stockholder approval requirements may block a bidder from implementing a merger even when the bidder controls the target's board of directors since stockholder approval may remain below the specified percentage (Linn & McConnell, 1983).

Classified board provisions segment (or stagger) the board of directors into classes with one class

standing for election each year. Typically, with a classified board provision, one-third of the board is elected each year for a three-year term. With a classified board, a new majority stockholder would have to wait for two annual meetings to attain majority representation on the board before being guaranteed a successful proposal of a merger for stockholder vote (DeAngelo & Rice, 1983).

The fair-price amendment requires supermajority voting approval by stockholders for transfer of control if the bidder does not offer a "fair price". Usually, the fair price is defined as the highest price paid by the bidder for any shares acquired in the target firm during a specified period or some premium over market price. The amendments are effective mainly against hostile two-tier tender offers (Jarrell & Poulsen, 1987).

Reduction in cumulative voting restricts the rights of stockholders to accumulate their votes in favor of a particular director or board of directors. With cumulative voting it may be possible for minority stockholders to elect some board members even if the majority of stockholders oppose their election. A reduction in cumulative voting rights reduces the minority stockholders' ability to elect their nominees as directors (Bhagat & Brickley, 1984) and thus makes the firm a less desirable takeover target.

Anti-greenmail provisions are amendments to the corporate charter which prohibit payment of greenmail. Greenmail involves private repurchase of a sizeable block of company stock at a premium, and often involves an agreement by the raider not to acquire the firm and displace incumbent management. Typical anti-greenmail charter amendments prohibit firms from repurchasing some or all of the common (voting) stock of a stockholder who acquired 5% or more of the outstanding common stock within the past three years (Bhagat & Jefferis, 1991).

Poison pill provisions provide target stockholders the right to purchase additional shares at a discount or to sell shares to the target at very attractive prices. The target stockholders' right to purchase at a discount is known as a flip-over plan (Malatesta & Walkling, 1988). The right to sell shares to the target at an attractive price is called a back-end plan (Ryngaert, 1988).

THEORETICAL PERSPECTIVES ON STOCKHOLDER WEALTH EFFECTS OF ANTITAKE-OVER AMENDMENTS

Two competing theoretical perspectives drive the research addressing stockholder wealth effects of the adoption of antitakeover amendments. One view is that amendments benefit stockholders and is known in the literature as the "stockholder interests hypothesis" (DeAngelo & Rice, 1983). A competing viewpoint known as the "management entrenchment hypothesis" is that antitakeover amendments are not in stockholders' best interests (Easterbrook & Fischel, 1981).

Stockholder Interests Hypothesis. According to the stockholder interests hypothesis, the market would react positively to amendment adoption for two reasons. First, the adoption of antitakeover amendments effectively creates a long-term contract with the current management team and may encourage them to make firm-specific capital investments and long-term investments which are in the long-run best interest of stockholders (Baysinger & Butler, 1985). Second, antitakeover amendments provide corporate management additional veto power in takeover situations and enable them to negotiate better deals on average for their stockholders (DeAngelo & Rice, 1983).

Management Entrenchment Hypothesis. According to the management entrenchment view, antitakeover amendments protect inefficient incumbent management that may indulge in shirking, featherbedding and maintaining short time horizons, each of which results in a present-value loss for the firm (Baysinger & Butler, 1985). Those who subscribe to the "management entrenchment" view also contend that antitakeover amendments reduce the probability of a firm receiving valuable takeover offers from alternative management teams, exacerbating the agency problem of the separation of ownership and control (Easterbrook & Fischel, 1981). Hence, a negative relationship between amendment adoption and stockholder returns is expected.

PREVIOUS EMPIRICAL WORK

Several studies test the stockholder interest hypothesis and the management entrenchment hypothesis by examining the stock price effects of the announcement of new information related to antitakeover amendment proposals. They interpret an average increase in stock price as support for the

stockholder interest hypothesis and an average decrease in stock price as support for the management entrenchment hypothesis.

The evidence of stockholder wealth effects of antitakeover amendments is mixed. Table 1 provides a list of prior studies.

-------Insert Table 1 about here -------

Mahoney and Mahoney (1993) indicate one reason for mixed results is the time period during which amendments were passed. They demonstrate that amendments adopted in the early 1970s have non-significant stock price impacts, and those adopted in the 1980s, during the takeover boom, have significantly negative stock price impacts. Some of the explanations they offer for the negative trend over time in the effect of antitakeover amendments include: changes in the composition of stockholders (Chaganti & Damanpour, 1991; Graves & Waddock, 1990), learning over time by stockholders[2] (i.e., stockholders may update their expectations of the effects of an antitakeover amendment after seeing the effects on firms which have passed them), and changes in the structure of the takeover market (Jarrell & Poulsen, 1987).

Another reason for mixed results is that early studies do not draw a distinction among amend-ments (DeAngelo & Rice, 1983; Linn & McConnell, 1983). They test whether all the examined amend-ments have either a positive or negative impact on stockholder wealth. Jarrell and Poulsen (1987) however, found that fair price requirements had little impact on stock value, and other amendments had a significantly negative effect. Since a majority of fair price amendments in Jarrell and Poulsen's (1987) sample were adopted in the 1980s, their results raise an important issue: Do all amendments adopted in the 1980s have a negative impact on stockholder wealth (as suggested by Mahoney & Mahoney, 1993), or are there differences in market reactions to amendments on grounds other than when they were adopted?

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[2] Learning over time implies neither information asymmetry (at any point in time) nor an inefficient market. We thank an anonymous reviewer and the editor for bringing this issue to our attention.

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DIFFERENCES AMONG AMENDMENTS

Walsh and Seward (1990) subscribe to the entrenchment view, but differentiate among takeover defense actions. They provide a useful framework to classify different managerial takeover defenses, and we use their framework to classify our antitakeover amendments (Table 2).

--------- Insert Table 2 about here ---------

The two dimensions Walsh and Seward (1990) use to categorize different takeover defenses into a two-by-two matrix are: whether defensive actions are operating or non-operating measures, and whether they require stockholder approval or not.

Operating measures result in changes in a firm's assets, financial structure or both. For example, managers of a firm may repurchase a large block of shares from a bidder to prevent the firm from being taken over (i.e., managers pay greenmail). This repurchase will be reflected in the company's balance sheet and is classified as an operating measure. Non-operating measures do not involve a change in a firm's balance sheet but nonetheless are believed to affect the probability of a successful takeover effort. For example, firms can change their charters to restrict the voting rights of shareholders. Walsh and Seward (1990) contend that: "shareholders are usually harmed more by operating than by non-operating defensive measures. Perhaps this is due to the latter's being likely to be less costly to reverse if circumstances warrant" (1990: 439). One can argue that increased costs of reversing these actions intensify agency problems even more than if these actions could be easily reversed. Moreover, Walsh and Seward's (1990) observation is based on empirical research that indicate strong negative market reactions to operating measures such as poison pills (see Table 1).

Another dimension on which Walsh and Seward (1990) categorize takeover defense measures is whether or not a measure requires stockholder approval. For instance, poison pill provisions do not require stockholder approval, whereas restriction of stockholder voting rights requires stockholder approval. Walsh and Seward indicate that: "Theoretically actions taken by management that do not require stockholder approval may be particularly damaging to shareholder interests [when compared to actions that require shareholder approval]" (1990: 438). Their conjecture is intuitive given that agency

problems (Eisenhardt, 1989; Oviatt, 1988) are likely to be higher when stockholders are not provided an opportunity to participate and curb actions that may be detrimental to them.

Walsh and Seward's (1990) framework implies that antitakeover amendments can be viewed as a continuum with one end representing the most harmful amendments from stockholders' viewpoint, and the other end representing least harmful amendments. Actions in cell 2 of Table 2 are predicted to be the most harmful actions from an agency perspective, because operating measures and those that do not require stockholder approval entail higher agency costs than non-operating measures or measures that require stockholder approval. Cell 3 represents least harmful actions from stockholders' viewpoint as they are non-operating measures and require stockholder approval. Cells 1 and 4 represent actions that fall between the two ends in their predicted effect on stockholder wealth, because they are either operating amendments or do not require stockholder approval but not both.

The six antitakeover amendments considered in this study fall in cells 2 and 3, which represent actions that fall in two ends of the continuum described (see Table 2). We examine differences between actions in these two cells because if Walsh and Seward's (1990) dimensions are critical to the market, we should certainly expect differences in market reactions to actions that fall in two ends of the continuum. More specifically, one should expect the market to react more negatively to the adoption of actions in cell 2 (operating measures that do not require stockholder approval) than to actions in cell 3 (non-operating measures that require stockholder approval). The above discussion leads to two hypotheses.

<u>Hypothesis 1:</u> **The market is likely to react negatively to the adoption of each and every antitakeover amendment.**

<u>Hypothesis 2:</u> **The market is likely to react more negatively to the adoption of operating amendments that do not require stockholder approval (poison pills) than to the adoption of non-operating amendments that require stockholder approval (i.e., supermajority requirements, classified boards provisions, fair price provisions, reduction in cumulative voting rights, or anti-greenmail provisions).**

EMPIRICAL ANALYSIS

The efficient capital market theory provides a framework for the empirical testing of our hypotheses (Bettis, 1983). We study stock price changes at the publication of news items relating to antitakeover amendments. Methodologies based on the market model using ordinary least squares

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(OLS) and using standard parametric tests are well-specified under a variety of conditions for daily stock return data (Brown & Warner, 1985) and are utilized here.

Stockholder wealth effects of the adoption of antitakeover amendments are tested by considering the equity value impact at the time of the antitakeover amendment proposal. The proxy statement mailing date is utilized as the best available estimate of the date of the first public announcement of antitakeover amendment consideration (Jarrell & Poulsen, 1987).

Our sample of firms proposing antitakeover amendments is derived from the Investor Responsibility Research Center (IRRC) (Rosenbaum, 1987, 1989). Our sample includes 379 firms adopting 483 antitakeover amendments for the 1984-1988 period. This large sample should reduce the level of statistical noise in measuring stock returns. The security market rates of return utilized in testing were taken from the CRSP (Center for Research in Security Prices, University of Chicago) daily file for firms listed on the New York Stock Exchange, the American Stock Exchange and the National Association of Security Dealers.

We expect any resulting changes in stock prices, due to the perceived effect of antitakeover amendments, to occur immediately around the proxy mailing date. We chose an event window of 50 days before the proxy mailing date (-50) to 10 days following the proxy mailing date (+10). An average of 27 trading days (and a median of 24) separates the board meeting date (when an amendment is passed) from the proxy mailing date (Linn & McConnell, 1983). Although it is against SEC rules to solicit actively votes before the proxy mailing date, the possibility remains that the board decision to adopt antitakeover amendments is leaked to some market participants. The market returns in the -40 to -20 interval roughly surround the board meeting date. We chose 50 days before the proxy mailing date to ensure the inclusion of the board meeting date. We chose 10 days after the proxy mailing date as a sufficient time period for the market to react fully to the antitakeover amendment provisions.

The statistical tests presented below consider the estimation of the market-price impact associated with public announcement of proposed antitakeover amendments. We utilize capital market residual

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analysis techniques. If we assume that security returns have a multivariate normal distribution, a single factor model consistent with the capital asset pricing model (Brown & Warner, 1985) can be formulated for time-event studies. Therefore, the statistical tests described below entail a joint hypothesis of market efficiency[3], the capital asset pricing model, and the effects of antitakeover amendments.

Specifically, the market model is assumed to be a valid representation of the stochastic process which generates returns for security j in time period t:

$$\tilde{R}_{jt} = \alpha_j + \beta_j \tilde{R}_{mt} + \tilde{\epsilon}_{jt} \qquad (1) \qquad \text{where}$$

$\tilde{R}_{jt}$ = stochastic return on security j over time period t

$\tilde{R}_{mt}$ = stochastic return on a market portfolio of common stocks over time period t, and

$\tilde{\epsilon}_{jt}$ = disturbance term for security j at time period t which is assumed to be normally distributed with zero mean, serially uncorrelated and has constant variance over time.

According to the market model, each security's period t return is expressed as a linear function of the corresponding time period's return on the market portfolio plus a random error term which reflects security specific effects.

The market model is implemented by computing ex-post abnormal returns for each security as

$$AR_{jt} = R_{jt} - (\hat{\alpha}_j + \hat{\beta}_j R_{mt}) \qquad (2)$$

where R_{jt} and R_{mt} are the observed returns for security j and the market portfolio, respectively, in time period t relative to the event date of interest.

The security specific parameters $\hat{\alpha}_j$ and $\hat{\beta}_j$ are estimated over a period of 110 days (-160 to -51) preceding the event date (Linn & McConnell, 1983). To reduce the impact of random estimation errors, portfolios are formed in event time such that each daily abnormal return is an equally weighted average of individual securities' abnormal returns for that common event date,

$$\overline{AR}_t = \sum_{j=1}^{N} AR_{jt} / N,$$

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[3] Event-study tests generally support the view that the market is semistrong-form efficient (Ross, Westerfield & Jaffe, 1990).

where N is the number of securities in the portfolio on event date t. Cumulative average abnormal returns are computed as:

$$CAR_t = \sum_{k=-50}^{t} \overline{AR}_k, \qquad \text{where } t = -50 \text{ through } +10.$$

To determine the statistical significance of the average abnormal returns, we employed a parametric mean test as described in Linn and McConnell (1983). The statistic used to test the null hypothesis is computed as:

$$Z = \overline{\overline{AR}}_t / S(\overline{\overline{AR}}), \qquad (3)$$

$$\text{where} \qquad \overline{\overline{AR}}_t = 1/N \left(\sum_{j=1}^{N} \hat{AR}_{jt} \right)$$

$$S(\overline{\overline{AR}}) = \left(T-2 / (N(T-4)) \right)^{1/2}$$

$$\text{and} \qquad \hat{AR}_{jt} = AR_{jt} / S_t(AR_j) \qquad \text{where}$$

$$S_t(AR_j) = \left(S_j^2 \left(1 + 1/T + (R_{mt} - \overline{R}_m)^2 / \sum_{t=1}^{T} (R_{mt} - \overline{R}_m)^2 \right) \right)^{1/2} \qquad \text{and}$$

S_j^2 = residual variance from the OLS estimation of the market model for security j

$\overline{R}_m$ = average return on the market portfolio computed over the same event period used to estimate the market model for security j

T = total number of days in the interval used to estimate the market model, and
N = number of securities in the portfolio of firms proposing antitakeover amendments.

The Z-statistic in (3) is distributed approximately unit normal for large N.

The test statistic of the null hypothesis that the cumulative average residual (CAR) is equal to zero is computed as:

$$Z_t = \overline{CAR}_t / S(\overline{\overline{AR}}), \qquad (4) \qquad \text{where}$$

$$\overline{CAR}_t = \left(1/N \sum_{j=1}^{N} \hat{CAR}_j \right)$$

$$\hat{CAR}_j = \left(\sum_{t=1}^{T} \hat{AR}_{jt} \right) / (T)^{1/2}$$

The Z-statistic in (4) is distributed approximately unit normal for large N.

RESULTS

Results for the individual amendments are provided in Table 3. Table 4 presents sample average and cumulative average abnormal rates of return (CARs), as well as the fraction of firms with negative CARs, for non-operating antitakeover amendments which require stockholder approval (supermajority, classified board, fair price, reduction in cumulative voting, and anti-greenmail). For the event window (-50, +10), the CAR over the 61 day period decreased by 2.4 percent. The decrease in the CAR is significantly different from zero at the 0.01 level using a two-tailed test. The result is consistent with the managerial entrenchment hypothesis.[4]

Table 5 presents the corresponding empirical results for the poison pill provisions. The CAR for the period (-50, +10) is -2.7 percent, which is statistically significant at the 0.01 level using a two-tailed t-test and is again consistent with Hypothesis 1.

----------- Insert Tables 3, 4 and 5 about here --------

In order to test for differences between the two groups, we compare the 61 day period mean CARs for the two groups (non-operating amendments that require stockholder approval and operating amendments that do not require stockholder approval) and find that the difference is not significant (the difference is 0.003 with t-statistic of 0.1986). This result is contrary to Hypothesis 2, which predicted that the market is likely to react more negatively to the adoption of operating amendments that do not require stockholder approval than to the adoption of non-operating amendments that require stockholder approval.

Several methodological issues concerning event studies must be addressed (Brown & Warner, 1985). A pre-event period was chosen to estimate the parameters α and β in the market model. These parameters may change due to the event, thus yielding potentially biased and inefficient estimates for the

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[4] Formally, the hypotheses which we are testing are:

H_0 : $CAR_{10} = 0$ Null hypothesis of no stockholder wealth effect
H_{1A} : $CAR_{10} > 0$ Supports the stockholder wealth hypothesis
H_{1B} : $CAR_{10} < 0$ Supports the managerial entrenchment hypothesis

market model. Two situations may cause the pre-event estimates of α's and β's to be unreliable. First, if rumors about a takeover of the firm circulated before the board meeting date (rumors which may have lead to the proposal of the antitakeover amendment), the α's in the pre-event period may be overestimated due to the positive stock impact of the rumor. In addition, if information of the proposal were "leaked" to some market participants the α's may be biased due to the leakage. We therefore replicated our event study test using a post-event estimation period ($+11$ to $+120$) in place of our pre-event estimation period (-160 to -51) to estimate α and β, and still found significantly negative CARs which is consistent with our earlier results supporting the managerial entrenchment hypothesis.

A consistent choice of market index is needed in order to properly interpret the results. The justification for the use of an equally weighted index is that, in practice, the precision with which beta and hence residuals are measured is greater with the equally weighted index than with the value weighted index (Brown & Warner, 1985).[5]

Recent research by Fama and French (1992) indicates that a simpler model than the Capital Asset Pricing Model (CAPM) can be employed to predict expected returns on a large sample of firms. Alternate proxies of risk, such as firm size and market to book ratios, can predict as much variance in returns as beta. CAPM does not allow for the "firm size effect" empirically found in the literature (where smaller firms have higher realized returns relative to larger firms), since β is the only measure of risk. However, the market model adjustment allows two measures of risk, the α term and the β term. If small firms truly earn higher returns than large firms, this difference will be captured by the α term in the OLS regression during the estimation period. Thus, if small firms earn more during the estimation period, they will be expected to earn more during the testing period. This adjustment by both an α and a β term makes the market model adjustment robust to extraneous effects such as size effects, industry effects, or market to book effects.

However, in order to test our conclusions under a different methodology, we adjust the firms'

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[5]   We thank an anonymous reviewer for bringing this issue to our attention.

returns by the mean return on a portfolio of stocks with similar market capitalization (number of shares times price per share). The results indicate that our conclusions are robust to the model specifications. The proposal of an antitakeover amendment results in a small but statistically significant fall in stock price of approximately 2 percent. The results across types of amendments are also confirmed, with no statistical difference between the operating amendments which do not require stockholder approval and the non-operating amendments which do require stockholder approval.

In addition, the market in which a stock trades may effect our results, since the uses of returns of firms which do not trade on major exchanges have potential sample biases and inefficiencies due, for example, to infrequent trading (Scholes & Williams, 1977). Our sample is derived from the IRRC publications which tend to follow larger firms which, in turn, tend to be traded on the exchanges. Therefore, few firms in our sample are traded on NASDAQ: 4 of the 195 firms adopting poison pills and 15 of the 184 firms adopting other amendments were traded on NASDAQ. Since these firms comprise only 5% of our sample the results are robust to the decision to include them. The CAR of firms not traded on NASDAQ and adopting poison pills was -0.0268 (t-stat of -2.79) and the CAR of firms not traded on NASDAQ and adopting other amendments was -0.0211 (t-stat of -2.34). The difference between these CARs is 0.0057, with associated t-statistic of 0.07.

Therefore, our conclusions appear robust to model specifications: The adoption of antitakeover amendments lead to small but statistically significant decreases in stock prices, but no difference between poison pill amendments and other amendments can be detected.

CONCLUSIONS

The purpose of this study was to examine the impact of the adoption of antitakeover amendments in the 1980s on stockholder value, and to examine whether differential wealth effects exist between types of amendments. We used Walsh and Seward's (1990) framework to categorize six antitakeover amendments into two groups, those that are predicted to be the most harmful to stockholders and those that are predicted to be the least harmful to stockholders.

Our empirical findings indicate that the market reacts negatively to the adoption of both groups

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of antitakeover amendments. The observed stock-price reaction to antitakeover amendments is thought to have at least three components: a negative component associated with the reduced probability of a successful offer, a positive component associated with a lowering of the costs of negotiating higher-valued offers, and a positive component associated with additional information about managers' expectations of a takeover. Our empirical results indicate that the negative component outweighs the sum of the positive components in both groups.

Negative market reactions support the managerial entrenchment view espoused by the U.S. Securities and Exchange Commission (1985), and by legal scholars such as Easterbrook and Fischel (1981). Protective responses while serving the interests of incumbent managements are dysfunctional from the standpoint of stockholders[6] (Williamson, 1975). While some in management may regard this as a jaundiced view, it is nonetheless the view we stand by, along with others such as Kesner and Dalton (1985) regarding antitakeover amendments.

Our results are particularly strong since the tests are biased against the managerial entrenchment hypothesis. The proposal of antitakeover amendments may provide information, signaling an increased probability that the firm may currently be a takeover target. The signal of a potential bidder to the target stockholders empirically leads to an increase in the stock price (Jarrell & Poulsen, 1987). Thus, the significant decline in the stock price around the event date of the antitakeover amendments, despite the positive signaling effect, strengthens our interpretation of the evidence in support of the managerial entrenchment hypothesis.

However, it is important to note that although we found a negative average impact, this result does not preclude the possibility that some firms' antitakeover amendments actually benefit stockholders. Our test is properly interpreted as providing evidence concerning the average effect of antitakeover

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[6] Our empirical results are consistent with the managerial entrenchment hypothesis but do not prove that managers are acting opportunistically. We thank the editor for bringing this point to our attention. Nevertheless, we concur with Williamson's observation that: "The contract between the firm and shareholders actually can be, and sometimes is, adjusted by making changes in the corporate charter. These changes appear, however, mainly to be initiated by the management and are frequently management-favoring in character" (1985, p. 305, footnote 9).

amendment proposals on stockholder wealth. With this important caveat clearly in mind, we have been persuaded by the empirical evidence that antitakeover amendments are generally detrimental to stockholders in support of Hypothesis 1.

With respect to differential wealth effects of antitakeover amendments, our results indicate no significant difference in market reactions to operating amendments that do not require stockholder approval and to non-operating amendments that require stockholder approval. These results provide evidence that stockholders do not discriminate between these amendments on the basis of the dimensions we studied.

Walsh and Seward's (1990) dimensions may not be expected to be critical in terms of stockholder wealth effects, as suggested by our results, since: (1) operating amendments, such as poison pills that have not been activated, may be as easily reversible as non-operating amendments and (2) stockholders in widely held corporations may be "rationally ignorant" (Baysinger & Butler, 1985) as they do not have the incentive to study closely every decision which is put to their approval. Rationally ignorant stockholders may be in the majority, in which case they may not participate in the voting process and hence be indifferent to Walsh and Seward's (1990) dimensions[7].

Based on our study it is premature to reject the importance of the two dimensions proposed by Walsh and Seward (i.e, operating versus non-operating amendments and stockholder approval versus non-stockholder approval). Further research efforts might consider whether informed investors (e.g., institutional investors) discriminate on the basis of their dimensions (Agrawal & Mandelker, 1990; Mallette & Fowler, 1992). Also, the presence of other governance mechanisms such as an independent board may affect stockholders' perceptions of Walsh and Seward's (1990) dimensions. Moreover, although these dimensions were not perceived differently by stockholders, these dimensions may be

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[7] Moreover, (back-end) poison pills in cell 2 and fair price amendments in cell 3 are both similar in intent (i.e., to prevent two-tier tender offers). Hence, our result of similar stock price reaction for fair price amendments and poison pill amendments in Table 3 might be expected. We thank Rita Kosnik for bringing this issue to our attention.

important predictors of other consequences of antitakeover amendments, such as probability of receiving takeover bids, future competitive position, and subsequent firm performance.

In summary, our study provides support for Walsh and Seward's description of antitakeover amendments as "entrenchment practices" (1990: 438). Thus, it is asserted that governance research in management science that builds on the premise that antitakeover amendments are entrenchment mechanisms is warranted. However, our empirical results do not provide support for systematic differences in market reactions to amendments classified on the basis of Walsh and Seward's (1990) framework.

TABLE 1

AUTHORS	SAMPLE	TYPE OF DEFENSE	EVENT WINDOW	CAR
Agrawal & Mandelker (1990)	356 amendments (1979-1985)	FP, CB, SM	(-40, +1)	-2.6 ***
Bhagat & Brickley (1984)	19 amendments (1962-1982)	RCV	(-1, +1)	-1.57 *
Choi, Kamma & Weintrop (1989)	267 amendments (1985-1986)	PP	(-1, +1)	-0.48 ***
DeAngelo & Rice (1983)	100 amendments (1974-1979)	CB, SM	(-40, +10)	-0.55
Eckbo (1990)	32 amendments (1984-1985)	AG	(0, +1)	-0.48
Jarrell & Poulsen (1987)	649 amendments (1979-1985)	FP (408 amend.)	(-20, +10)	-0.65
		SM (48 amend.)	(-20, +10)	-4.92 **
		CB (28 amend.)	(-20, +10)	-1.29
Linn & McConnell (1983)	388 amendments (1960-1980)	CB, SM, FP	(-90, +90)	0.99
Mahoney & Mahoney (1993)	409 amendments (1974-1988)	CB, SM	(-50, +10)	-1.6 ***
Malatesta & Walkling (1988)	113 amendments (1982-1986)	PP	(-1, 0)	-0.915 ***
Ryngaert (1988)	283 amendments (1982-1986)	PP	(-1, 0)	-0.34 *

AG = Anti-greenmail
CB= Classified Board
FP = Fair price
PP = Poison Pill
RCV= Reduction in Cumulative Voting
SM = Supermajority

Note: date 0 = proxy mailing date

* = significant at 10% level
** = significant at 5% level
*** = significant at 1% level

TABLE 2

Antitakeover Defenses

	Operating	Nonoperating

Stockholder Approval Required	**1**
	
	Example:
	    Dual-class
	    recapitalizations
		3
		
		1. Supermajority
		   amendments
		2. Classified Boards
		3. Fair price amendments
		4. Reduction in cumula-
		   tive voting rights
		5. Anti-greenmail

No Stockholder Approval Required	**2**
	
	1. Poison pills
		4
		
		Example:
		    Golden
		    parachutes

Mechanisms intended to restrict transfer of managerial control (adapted from Walsh & Seward, 1990: 438). This paper focuses on amendments in cells 2 and 3.

TABLE 3

Cumulative Average Abnormal Residuals 10 days after the event (CAR_{10}) for each of the six antitakeover provisions.

Provisions by type	Sample Size	CAR_{10}	$t(CAR_{10})$
Non-operating and Require Stockholder Approval			
Supermajority	20	0.0292	0.3418
Classified board	104	-0.0140	-0.8612
Fair price	110	-0.0282	-2.1147
Reduction in cumulative voting	21	-0.0590	-1.6668
Anti-greenmail	33	-0.0428	-1.6249
Operating and Do Not Require Stockholder Approval			
Poison Pills	195	-0.0272	-2.9298

TABLE 4
Supermajority, Classified Boards, Fair price, Reduction in Cumulative Voting, and Anti-greenmail

Daily abnormal returns surrounding the event date for the proxy mailing date of one or more of the 5 amendments.   (Number of observations: N=184)

Event date	Average residual		CAR		Fraction negative	
-50	-0.0009		-0.0009		0.5628	
-40	0.0030		-0.0058	*	0.5738	*
-39	0.0014		-0.0044	*	0.5902	**
-38	0.0003		-0.0041	*	0.5956	**
-37	-0.0016		-0.0057	*	0.5847	*
-36	-0.0039	**	-0.0096	**	0.6175	**
-35	-0.0021		-0.0177	**	0.6175	**
-34	-0.0031	**	-0.0148	**	0.6339	**
-33	-0.0013		-0.0162	**	0.6120	**
-32	0.0019		-0.0143	**	0.5792	*
-31	-0.0006		-0.0149	**	0.5902	**
-30	-0.0022	*	-0.0171	**	0.6011	**
-29	-0.0002		-0.0172	**	0.6011	**
-28	0.0007		-0.0166	**	0.6066	**
-27	0.0012		-0.0154	**	0.6066	**
-26	0.0002		-0.0152	**	0.5792	*
-25	-0.0012		-0.0164	**	0.5792	*
-24	0.0018		-0.0145	**	0.5902	**
-23	-0.0008		-0.0154	**	0.5574	
-22	0.0001		-0.0153	**	0.5792	*
-21	-0.0004		-0.0156	**	0.5792	*
-20	-0.0007		-0.0164	**	0.5574	
-19	-0.0016		-0.0179	**	0.5638	
-18	-0.0006		-0.0186	**	0.5847	*
-17	0.0008		-0.0177	**	0.5792	*
-16	0.0015		-0.0162	**	0.5628	
-15	0.0015		-0.0147	*	0.5792	*
-14	-0.0012		-0.0159	*	0.5902	**
-13	-0.0010		-0.0169	**	0.6011	**
-12	0.0020		-0.0149	*	0.5628	
-11	0.0004		-0.0145	*	0.5574	
-10	0.0008		-0.0137	*	0.5464	
- 9	0.0001		-0.0136	*	0.5792	*
- 8	0.0000		-0.0135	*	0.5738	*
- 7	-0.0003		-0.0139	*	0.5847	*
- 6	-0.0010		-0.0149	*	0.5902	**
- 5	-0.0009		-0.0158	*	0.5847	*
- 4	-0.0020		-0.0178	*	0.5847	*
- 3	-0.0009		-0.0187	*	0.5902	**
- 2	-0.0004		-0.0191	*	0.6011	**
- 1	-0.0015		-0.0207	**	0.5792	*
0	-0.0020		-0.0227	**	0.5738	*
+ 1	-0.0007		-0.0234	**	0.5792	*
+ 2	-0.0024		-0.0257	**	0.5902	**
+ 3	-0.0004		-0.0261	**	0.5902	**
+ 4	0.0005		-0.0256	**	0.5847	**
+ 5	0.0007		-0.0250	**	0.5902	**
+ 6	0.0005		-0.0245	**	0.5847	*
+ 7	0.0008		-0.0236	**	0.5902	**
+ 8	-0.0025	*	-0.0261	**	0.5902	**
+ 9	0.0005		-0.0267	**	0.5738	*
+10	0.0028	*	-0.0239	**	0.5847	*

* indicates statistical significance at the 5% level using a two-tailed test.
** indicates statistical significance at the 1% level using a two-tailed test.

TABLE 5
Poison Pill Provisions

Daily abnormal returns surrounding the event date for the proxy mailing date of poison pill amendments. (Number of observations: N=1)

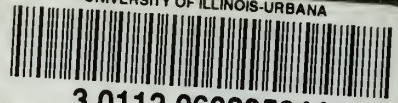| Event date	Average residual		CAR		Fraction negative	
-50	-0.0015		-0.0015		.5744	
-40	-0.0015		-0.0028		.5333	
-39	-0.0033	**	-0.0061		.5538	
-38	-0.0003		-0.0065		.5590	
-37	-0.0016		-0.0081		.5436	
-36	0.0004		-0.0077		.5333	
-35	-0.0009		-0.0086		.5436	
-34	-0.0016		-0.0102	*	.5436	
-33	-0.0009		-0.0111	*	.5179	
-32	-0.0005		-0.0116	*	.5385	
-31	-0.0012		-0.0128	*	.5538	
-30	-0.0001		-0.0129	*	.5641	
-29	0.0001		-0.0127	*	.5385	
-28	0.0015		-0.0113		.5077	
-27	-0.0005		-0.0118		.5077	
-26	-0.0006		-0.0124		.5231	
-25	0.0003		-0.0121		.5128	
-24	0.0020		-0.0101		.5077	
-23	0.0004		-0.0097		.5179	
-22	-0.0003		-0.0101		.5077	
-21	0.0016		-0.0085		.5026	
-20	0.0006		-0.0079		.4974	
-19	-0.0013		-0.0092		.5026	
-18	-0.0004		-0.0096		.5026	
-17	-0.0004		-0.0099		.5333	
-16	-0.0004		-0.0104		.5179	
-15	0.0026	**	-0.0078		.5231	
-14	0.0011		-0.0067		.5179	
-13	0.0003		-0.0067		.5231	
-12	-0.0013		-0.0064		.5385	
-11	-0.0023	*	-0.0077		.5179	
-10	-0.0006		-0.0101		.5333	
- 9	-0.0008		-0.0115		.5179	
- 8	-0.0020		-0.0135		.5128	
- 7	0.0008		-0.0127		.5128	
- 6	-0.0035	**	-0.0162	*	.5231	
- 5	-0.0006		-0.0168	*	.5231	
- 4	-0.0021		-0.0189	*	.5385	
- 3	-0.0003		-0.0191	*	.5436	
- 2	-0.0004		-0.0196	*	.5641	*
- 1	-0.0021		-0.0216	*	.5641	*
0	0.0008		-0.0208	*	.5385	
+ 1	-0.0012		-0.0220	*	.5436	
+ 2	-0.0017		-0.0237	*	.5436	
+ 3	-0.0002		-0.0239	*	.5333	
+ 4	-0.0006		-0.0245	**	.5641	*
+ 5	0.0003		-0.0242	**	.5641	*
+ 6	0.0001		-0.0241	**	.5692	*
+ 7	-0.0006		-0.0247	**	.5692	*
+ 8	-0.0013		-0.0260	**	.5590	
+ 9	-0.0011		-0.0271	**	.5590	
+10	-0.0001		-0.0272	**	.5590	

* indicates statistical significance at the 5% level using a two-tailed test.
** indicates statistical significance at the 1% level using a two-tailed test.

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